No. 9463

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

8

ALBERT K. MILLER,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

OPENING BRIEF FOR PETITIONER.

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OPENING BRIEF FOR PETITIONER.

OPINION BELOW.

The opinion below is the opinion of the United States Board of Tax Appeals (R. 14-19), which is reported in 40 B.T.A. 514.

JURISDICTION.

This appeal involves income taxes for the year 1933 and is taken from the decision of the Board of Tax Appeals entered October 26, 1939 (R. 19-20). Petition for Review was filed January 24, 1940 (R. 20-25), pursuant to the provisions of Section 1001-3 of the Revenue Act of 1926, as amended by Section 603 of the Revenue Act of 1928, Section 1101 of the Revenue Act of 1932 and Section 519 of the Revenue Act of 1934.

QUESTION PRESENTED.

Whether a net loss sustained by the Petitioner during the calendar year 1932, attributable to the operation of his business may be brought forward and claimed as a deduction from gross income in his tax return filed for the calendar year 1933, under Section 117 of the Revenue Act of 1932.

STATUTES INVOLVED.

Revenue Act of 1932.

Sec. 117. Net Losses.

(a) Definition of "Net Loss".—As used in this section the term "Net Loss" means the excess of the deductions allowed by this title over the gross income, with the following exceptions and limitations:

(1) Non-Business Deductions.—Deductions otherwise allowed by law not attributable to the operations of a trade or business regularly carried on by the taxpayer shall be allowed only to the extent of the amount of the gross income not derived from such trade or business;

(2) Capital Losses.—In the case of a taxpayer other than a corporation, deductions for capital losses otherwise allowed by law shall be allowed only to the extent of the capital gains;

(3) Depletion.—The deduction for depletion shall not exceed the amount which would be allowable if computed without reference to discovery value, or to percentage depletion under Section 114(b), (3) or (4);

(4) Dividends.—The deduction provided for in Section 23(p) of amounts received as dividends shall not be allowed;

(5) Interest.—There shall be included in computing gross income the amount of interest received free from tax under this title, decreased by the amount of interest paid or accrued which is not allowed as a deduction by Section 23(b);

(6) Net Loss Not to Produce Net Loss.—In computing the net loss for any taxable year a net loss for a prior year shall not be allowed as a deduction.

(b) Net Loss as a Deduction.—If, for any taxable year, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount thereof shall be allowed as a deduction in computing the net income of the taxpayer for the succeeding taxable (hereinafter in this section called "second year"); the deduction in all cases to be made under regulations prescribed by the Commissioner with the approval of the Secretary.

(c) Capital Net Gain in Second Year.—If in the second year the taxpayer (other than a corporation) has a capital net gain, the deduction allowed by subsection (b) of this section shall first be applied as a deduction in computing the ordinary net income for such year. If the deduction is in excess of the ordinary net income (computed without such deduction) the amount of such excess shall then be applied against the capital net gain for such year.

National Industrial Recovery Act, 48 Stat. 208.
Title II.

Sec. 218(a). Effective as of January 1, 1933, Sections 117, 23(i), 169, 187 and 205 of the Revenue Act of 1932 are repealed.

STATEMENT.

The material facts as found by the Board of Tax Appeals (R. 15), are as follows:

The Petitioner is a resident of San Francisco, California. Petitioner filed his income tax return for the year 1933 with the collector at San Francisco. During the calendar years 1932 and 1933, Petitioner was engaged in business as a trader in securities listed on various stock exchanges in the United States. During the calendar year 1932 the Petitioner sustained a net loss, attributable to the operation of his business, in an amount in excess of $63,426.02. That $63,426.02 of which he brought forward and claimed as a deduction from gross income in his income tax returns filed for the year 1933 under Section 117 of the Revenue Act of 1932. The Respondent, in determining the deficiency, disallowed the amount of $63,226.02 instead of the full amount claimed by the Petitioner on his return. Claim is made by the Respondent for the increased deficiency in tax which would result from the disallowance of the full amount of $63,426.02 instead of $63,226.02.

The Respondent disallowed the deduction on the ground that, since Section 117 of the Revenue Act of

1932 had been specifically repealed by Section 218(a) of the National Industrial Recovery Act, effective as of January 1, 1933, Petitioner could not deduct in 1933 net loss brought forward from 1932 (R. 16). The Petitioner contends that Section 218(a) of the National Industrial Recovery Act is unconstitutional and that, consequently, Section 117 of the Revenue Act of 1932 was not repealed, and that therefore the statutory net loss sustained in 1932 is deductible in 1933 (R. 16).

STATEMENT OF POINTS TO BE URGED.

1. The Board of Tax Appeals erred in holding that the Commissioner of Internal Revenue was correct in disallowing the deduction in 1933 of the statutory net loss sustained in 1932 in the sum of $63,426.02 (R. 23).

2. The Board of Tax Appeals erred in holding that Section 218(a) of the National Industrial Recovery Act, 46 Stat. 208, is valid, not violating any provisions of the Constitution of the United States (R. 23).

3. The Board of Tax Appeals erred in holding that Section 117 of the Revenue Act of 1932 has been repealed (R. 23).

4. The Board of Tax Appeals erred in holding that there was a deficiency tax in the amount of $2,202.80 due from the Petitioner for the calendar year 1933 (R. 24).

5. The Board of Tax Appeals erred in that its decision is not supported by the evidence and is contrary to law (R. 24).

6. The Board of Tax Appeals erred in holding that Section 218(a) of the National Industrial Recovery Act, 46 Stat. 208, is applicable to the calendar year 1933 and to the Income Tax Return filed for said calendar year (R. 31).

SUMMARY OF ARGUMENT.

The only question involved in this case is whether certain deductions claimed by the Petitioner in the sum of $63,426.02, which was a net loss arising from his business during the calendar year 1932, was a proper deduction in his income tax return for the calendar year 1933. Said deduction being made by said Petitioner pursuant to the provisions of Section 117 of the Revenue Act of 1932.

ARGUMENT.

A. SECTION 117 OF THE REVENUE ACT OF 1932 WAS NOT REPEALED.

The Petitioner contends that Section 117 of the Revenue Act of 1932 was not repealed by Section 218(a) of the National Industrial Recovery Act, as it has been held by the Supreme Court of the United States that the National Industrial Recovery Act is unconstitutional. *A. L. A. Schechter Poultry Corporation, et al. v. United States,* 295 U. S. 495. Many leading cases have held that the discretion and control given the President of the United States by said Act was absolute and that it was clearly an unconstitu-

tional delegation of legislative power. In said cases it clearly appeared that the Supreme Court of the United States realized the danger of centralizing the power of the Federal Government, a situation which the framers of the Constitution guarded against as far as possible.

> *Duke Power Co. v. Greenwood County, et al.,* 12 Fed. Supp. 70.

It was clearly held in the case of *Panama Refining Co. v. Ryan, et al.,* 293 U. S. 388, that the National Industrial Recovery Act involved an unconstitutional delegation of legislative power by the Congress to the President. It was held in the last mentioned case that a delegation of legislative power to an administrative officer was not brought within the permissive limits of such delegation by prescribing the public good as the standard for the administrative officer's action. It was held that the delegation by Congress of its essential legislative functions was precluded by the provisions of the Federal Constitution. That all legislative powers granted to the Federal Government shall be vested in Congress and empowering Congress to make all laws which shall be necessary and proper for carrying into execution its general powers, but that power vested in Congress could not and should not be delegated to any other person or group of persons. The Supreme Court held that the passage of said Act was an effort to delegate such power to the President, which was unconstitutional. The above mentioned views of the Court were upheld in the case of *Hart Coal Corporation v. Sparks,* 7 Fed. Supp. 16. Again

in the leading case of *Schechter Poultry Corporation v. United States,* 295 U. S. 495, it was held that said Act was unconstitutional. The Supreme Court stated that the fact Congress was confronted with a grave national crisis should be considered, but such an argument necessarily stops short of an attempt to justify action which lies outside the sphere of constitutional authority. Extraordinary conditions do not create or enlarge constitutional power. The Constitution established a national government with powers deemed to be adequate, as they have proved to be both in war and in peace, but the powers of the national government are limited by constitutional grants. Those who act under these grants are not at liberty to transcend the imposed limits because they believe that more or different power is necessary. The Supreme Court in this case went further to say that Congress is not permitted to abdicate or to transfer to others the essential legislative functions with which it is thus vested. Congress cannot delegate legislative power to the President to exercise an unfettered discretion to make whatever laws he thinks may be needed or advisable for the rehabilitation and expansion of trade or industry. By the provisions of said Act it is left to the discretion of the President to impose his own conditions in carrying out the provisions of the Act. Such sweeping delegation of legislative power is clearly unconstitutional.

The Petitioner contends that when the President was given the power to amend the provisions of the Revenue Act of 1932 by repealing Section 117 thereof

by enacting Section 218(a) of the National Industrial Recovery Act, he was delegated a power by Congress which was vested in Congress and a power which Congress could not abdicate or transfer to any other person or group of persons, and, such effort on the part of Congress to so transfer was unconstitutional.

The Board of Tax Appeals in considering this question takes the position that even though Title I of the National Industrial Recovery Act was unconstitutional still it would not have any effect on Title II of the Act as such was entirely inseparable from Title II because of the separability clause in the Act (Section 303) and that the effect of this clause is to create a presumption in favor of separability.

In support of their position the Board of Tax Appeals cites the case of *Lynch v. United States,* 292 U. S. 571. However, upon examining this case it is found that on page 586 the following statement is made by the Court:

> "A provision within the legislative power may be allowed to stand if it is separable from the bad. But no provision however unobjectionable in itself can stand unless it appears both that, standing alone, the provision can be given legal effect and that the legislature intended the unobjectionable provision to stand in case other provisions held bad should fall."

Petitioner agrees that the above is a correct statement of the law, but that in the case at hand it is impossible to separate the two titles, to wit, Title I and Title II, of the National Industrial Recovery Act

and declare one unconstitutional and the other constitutional, because Title II includes certain provisions which have been placed therein in order that the provisions of Title I may be carried out. Also, there is no showing of legislative intent that if Title I should be declared unconstitutional Title II should continue to remain in full force and effect. The separability clause was included in the Act so that if any section was declared unconstitutional the whole Act would not be declared unconstitutional, but the separability clause was not included in order to save the Act when the main title of the Act was declared unconstitutional. It is also the contention of the Petitioner that Section 218(a) of said Act cannot be singled out and considered constitutional when the main body of the Act is determined by the Supreme Court of the United States to be unconstitutional because even if some sections of the Act were licit, still the licit and illicit sections are so combined and welded as to be incapable of severance without destructive mutilation. Therefore, since the essential features of the Act, its very bone and sinew, are illicit, and there being no opportunity in such circumstances for the severance of the infected parts, the entire Act must collapse and be deemed unconstitutional.

Schechter Poultry Corporation v. United States, 295 U. S. 495;

Kent Stores of New Jersey, et al. v. Wilentz, et al., 14 Fed. Supp. 1;

In re: American States Public Service Co., 12 Fed. Supp. 667.

B. CONSTITUTIONALITY OF SECTION 218 (a) OF THE NATIONAL INDUSTRIAL RECOVERY ACT HAS NEVER BEEN CONSIDERED.

The Petitioner contends that the mere fact that other sections of Title II of the National Industrial Recovery Act have been considered and have been deemed constitutional by the Courts does not in turn make Section 218(a) of Title II of the National Industrial Recovery Act constitutional. The Board of Tax Appeals sets forth as one of its main arguments in support of its decision that the fact that Section 215 (d) and (f) and Section 216 (a) of the National Industrial Recovery Act have been considered constitutional, that therefore all the provisions of Title II of the National Industrial Recovery Act are constitutional. It is very apparent that such does not follow and is not the law. Upon examining the cases, it clearly appears that the reasons certain sections were determined to be constitutional are entirely foreign from the reasons which the Petitioner contends renders Section 218(a) unconstitutional. In the case of *A. J. Crowhurst & Sons, Inc.,* 38 B.T.A. 1072, which involves Section 215 (d) and (f) of the National Industrial Recovery Act, the Board of Tax Appeals held that such section was constitutional although the Petitioner was not allowed to file an amended return and show a second declaration of value because such did not deprive the Petitioner of due process of law under the 5th Amendment. The Court stated that to the contrary the due process principle seemed to be satisfied by the procedure specified and permitted by the statute, that is, the filing of the

original declaration of value. Under this section the taxpayer was given the opportunity to file the original declared value return and was, therefore, not deprived of his property and it followed that the section was not unconstitutional. In the case of *W. & K. Holding Corporation,* 38 B.T.A. 830, which involved the constitutionality of Section 216(a) of the National Industrial Recovery Act, the Board held here again that such section was constitutional and stated at page 847:

> "Here, with full knowledge of the facts as to value and of its net income, the Petitioner made what is now claimed to be a grossly excessive declaration expressly intended to wipe out any profits tax. The effect of its action is that it has secured the benefit of a lower tax than it would have had to pay if it had made a lower valuation. Its claim is not now directed to the right to amend to show the actual value, but it seeks to strike down the whole statute as void for failure to set a guide for declaration of value. There is nothing in the statute which prohibits a taxpayer from declaring the actual value."

Here the taxpayer is endeavoring to undo something which he has done to himself, the results of which is causing him a direct injury and harm. However, such injury did not result from any enforcement of the provisions of the Act but from the actions of the taxpayer himself. Therefore, it is clear that these cases which held certain sections of Title II of the National Industrial Recovery Act to be constitutional have no bearing whatsoever on the constitutionality of Section 218(a) of Title II of the National In-

dustrial Recovery Act because these cases did not consider Section 218(a) nor did they take into consideration the same questions which the Petitioner is raising in the case at hand.

The Board of Tax Appeals also cites the case of *Allied Agents, Inc. v. United States,* 26 Fed. Supp. 98, in support of its position that Title II of the National Industrial Recovery Act is constitutional in its entirety. However, it is clearly stated in that case that the question of the constitutionality of the National Industrial Recovery Act was not raised and although the Court did state that had the question been raised they would have considered Section 215 of the National Industrial Recovery Act constitutional, however this is only dicta and cannot be considered authority in support of the constitutionality of Section 215 of Title II of the National Industrial Recovery Act, much less Section 218(a) of the Act.

In the case of *Chicago Telephone Supply Co. v. United States,* 23 Fed. Supp. 471, the Court considered Section 701 and Section 702 of the Revenue Act of 1934, which were similar to certain sections of Title II, and the Court stated that the validity of such sections was not free from doubt.

Therefore, the Petitioner contends that the constitutionality of Section 218(a) of the National Industrial Recovery Act has never been raised or considered before. Also, the mere fact certain provisions of Title II were considered and held for certain reasons to be constitutional does not have any bearing on

the constitutionality of Section 218(a) even if the same questions had been raised which are now being raised in this case.

C. PETITIONER IS BEING DEPRIVED OF HIS PROPERTY WITHOUT DUE PROCESS OF LAW AND IN VIOLATION OF THE 5TH AMENDMENT TO THE CONSTITUTION OF THE UNITED STATES.

It is the contention of Petitioner that if Section 218(a) is allowed to stand it will result in the taking of property without due process of law which is in violation of the 5th Amendment and, therefore, unconstitutional. The Act in question was enacted in June, 1933, to take effect as of January 1, 1933. The Petitioner in the course of his business as a trader in securities in the year 1932 sustained a net loss of approximately $100,000.00. At the time he sustained said loss Section 117 of the Revenue Act of 1932 was in full force and effect, which allowed net losses sustained in one year to be used as a deduction from gross income in the same year or to be brought forward and used as a deduction from the gross income for the next year. Therefore, your Petitioner, with this situation in mind, took the net loss in question and used part of it as a deduction in 1932 and carried the balance of the net loss, to-wit, $63,426.02, forward and set it up as a deduction in his income tax return for the year 1933. Thereafter, in June, 1933, the National Industrial Recovery Act was passed and Section 218(a) thereof repealed Section 117 of the

Revenue Act of 1932, thereby denying your Petitioner the right to deduct the balance of his net loss from his gross income in his income tax return for 1933. In other words, after your Petitioner had been lulled into a sense of security and had been required to commit and place himself in a position which he could not change and could thereafter in no way protect his property, Section 218(a) of the National Industrial Recovery Act was passed and thus deprived him of the protection he had been promised and deprived him of his property without due process of law. We are aware of the fact that the Board of Tax Appeals is correct when it states that certain income tax statutes have been retroactive in effect and have been upheld by the Courts. However, in all cases in which such has been the fact the statutes have only been retroactive for a short period of time and have affected only transactions which have taken place during the year in which the statute was enacted.

In the case of *Brushaber v. Union Pacific R. R. Co.*, 240 U. S. 1, cited by the Board of Tax Appeals, the statute which provided for a general yearly income tax was retroactive for a very limited and short period of time.

In the case of *United States v. Hudson,* 299 U. S. 498, the Court stated at pages 500 and 501:

> "As respects income tax statute, it long has been the practice of Congress to make them retroactive for relatively short periods so as to include profits from transactions consummated while the statute was in process of enactment, or within

so much of the calendar year as proceeded the enactment; and repeated decisions of this Court have recognized this practice and sustained it as consistent with the due process of law clause of the Constitution. * * * The period of retroactivity prescribed for this taxing provision reaches backward from June 19, 1934, the date of the Act, to and including May 15, 1934,—35 days. On May 22nd the President sent to Congress a message recommending legislation for increasing the amount of silver in our monetary stocks and further recommending the imposition of a tax of at least 50 per cent on profits accruing from private dealing in silver. The bill which became the Silver Purchase Act was introduced May 23rd in response to this message. In these circumstances we think the period of retroactivity fixed in the Act is not unreasonable, but consistent with the practice sustained by this Court in the cases already cited. * * *".

The case last cited is also a case which the Board of Tax Appeals relies upon in support of its decision and clearly shows that the question of retroactivity is one of degree and one which is substantiated only when it affects transactions which have taken place during the year in which the act was enacted. In considering the other cases which are cited by the Board of Tax Appeals in support of its decision, we respectfully call the Court's attention to the case of *Phipps v. Bowers,* 49 Fed. (2d) 996. In this case the Court stated at page 997:

"It is objectionable where an attempt is made to attach further consequences to events that were

> completed in the past and by which a radical change of such events takes place (Nichols v. Coolidge, 274 U. S. 531). But where there is no offense against fair play, as the term is used in the field of congressional power of taxation, there is no constitutional impediment."

This case also substantiates the position taken by the Petitioner and it is also entirely distinguishable from the case at hand, because, in our case, if Section 218(a) is allowed to take effect it will attach further consequences to events that have been completed in the past, to-wit, the net loss sustained in 1932, and it will be offensive to fair play because the Petitioner having changed his position, it is now impossible for him to change back to his original position, which is entirely unequitable and against all interpretation of fair play.

In the cases of *Edgar Stanton, et al., Executors,* 34 B.T.A. 451, and *Chester A. Souther,* 39 B.T.A. 197, which are cited by the Board of Tax Appeals, the transactions involved in these cases took place during the same year the law was changed. In the *Souther* case, the Revenue Act of 1934 taxed transactions which took place in 1934 and which took place prior to the passage of the Act, to-wit, May 10, 1934, but not transactions which took place prior to January 1, 1934, and thus the Court held that the case did not violate the 5th Amendment to the Constitution.

The Board of Tax Appeals states that certain cases which were cited by the Petitioner in support of his

contention that, because of the retroactivity effect of the statute in question, the same violates the 5th Amendment to the Constitution are not applicable as no income tax statutes were involved in any of those cases. However, in examining the cases which the Board of Tax Appeals cites in support of its position it will be noted that these cases rely on the cases which the Petitioner cited.

The cases cited by the Petitioner in support of his position are as follows:

Nichols v. Coolidge, 274 U. S. 531;
Untemeyer v. Anderson, 276 U. S. 440;
Coolidge v. Long, 282 U. S. 581;
Milliken v. United States, 283 U. S. 15.

We do not understand the Board of Tax Appeals' position that, since the cases do not involve income tax statutes, they do not have any bearing on the case at hand because all the cases so cited, if they do not consider income tax statutes, they do consider estate tax statutes and the questions involved, if not identical, are very similar.

In the case of *Nichols v. Coolidge,* 274 U. S. 531, the question here involved was whether property deeded in 1917 by decedent through duly executed deeds and without valuable consideration, some to trustees and some directly to her children, was taxable under the Revenue Act of 1919, and the Court held at page 542 and page 543 as follows:

> "This court has recognized that a statute purporting to tax may be so arbitrary and capricious

as to amount to confiscation and offend the 5th Amendment. * * * And we must conclude that Sec. 402 (c) of the statute here under consideration, in so far as it requires that there shall be included in the gross estate the value of property transferred by a decedent prior to its passage merely because the conveyance was intended to take effect in possession or enjoyment at or after his death, is arbitrary, capricious and amounts to confiscation. Whether or how far the challenged provision is valid in respect of transfers made subsequent to the enactment, we need not now consider."

In the case of *Untemeyer v. Anderson,* 276 U. S. 440, a gift made during the calendar year 1924 and prior to June, 1924, the date when the Revenue Act of 1924 became a law, was not made taxable by this Act; but if intended that it should be, the Act, in so far as it related to a gift so made was void because in violation of the 5th Amendment to the Constitution of the United States. The Court held at page 445 as follows:

"In the light of arguments advanced by counsel in the present cause the matter has been considered by all members of the court and a majority of them are of opinion that the gift tax provisions of the Act of 1924 here challenged must be construed as applicable to gifts made during the entire calendar year 1924. And, further, that so far as applicable to bona fide gifts not made in anticipation of death and fully consummated prior to June 2, 1924, those provisions are arbitrary and invalid under the due process clause of the 5th

Amendment. The mere fact that a gift was made while the bill containing the questioned provisions was in the last stage of progress through Congress we think is not enough to differentiate this cause from the former one and to relieve the legislation of the arbitrary character there ascribed to it. To accept the contrary view would produce insuperable difficulties touching interpretation and practical application of the statute and render impossible proper understanding of the burden intended to be imposed. The taxpayer may justly demand to know when and how he becomes liable for taxes—he cannot foresee and ought not to be required to guess the outcome of pending measures. The future of every bill while before Congress is necessarily uncertain. The will of the lawmakers is not definitely expressed until final action thereon has been taken."

Coolidge v. Long, 282 U. S. 581.

In the case of *Blodgett v. Holden,* 275 U. S. 142, the Court stated at page 147:

"In Nichols v. Coolidge (May 31, 1927) [274 U. S. 531, 71 L. Ed. 1184, 52 A.L.R. 1081, 47 Sup. Ct. Rep. 710], this court pointed out that a statute purporting to lay a tax may be so arbitrary and capricious that its enforcement would amount to deprivation of property without due process of law within the inhibition of the 5th Amendment. As to the gifts which Blodgett made during January, 1924, we think the challenged enactment is arbitrary and for that reason invalid. It seems wholly unreasonable that one who, in entire good faith and without the slightest premonition of such consequence, made absolute

disposition of his property by gifts should thereafter be required to pay a charge for so doing."

In the dissenting opinion in the *Blodgett* case, Justice Holmes stated at page 147:

> "Although research has shown and practice has established the futility of the charge that it was a usurpation when this court undertook to declare an act of Congress unconstitutional, I suppose that we all agree that to do so is the gravest and most delicate duty that this court is called on to perform. Upon this, among other considerations, the rule is settled that as between two possible interpretations of a statute, by one of which it would be unconstitutional and by the other valid, our plain duty is to adopt that which will save the act."

At page 148:

> "If when the statute was passed it had been well recognized that Congress had no power to have tax past gifts I think that we should have no trouble in reading the act as meant to operate only from its date and only to tax gifts thereafter made. If I am right, we should read it in that way now."

At page 149:

> "I think it tolerably plain that the act should be read as referring only to transactions taking place after it was passed, when to disregard the rule 'would be to impose an unexpected liability that if known might have induced those concerned to avoid it and to use their money in other ways.' "

In the case of *Del Mar Addition, et al. v. Commissioner of Internal Revenue,* 40 B.T.A. No. 126, the Board held that in this case retroactivity of the statute made the same unconstitutional because it was arbitrary and capricious and violated the due process clause of the 5th Amendment to the Constitution.

In the case of *Beck v. Graves,* 21 N. E. (2d) 371, the Court stated at page 372:

> "While it is true that not all retroactive statutes are void, nevertheless, it is a fundamental rule of construction that retroactive operation of statutes is not favored by the Courts and will not be given such construction unless the language expressly by necessary implication requires it. Whether a statute, which by its express terms is retroactive, will be sustained is usually a question of degree. Taxing statutes, which by their terms, were retroactive for short periods have been held to be valid."

In the case of *Commissioner of Internal Revenue v. Wilshire Oil Co.,* 95 Fed. (2d) 971, the Court held at page 973:

> "It is a sufficient answer to this contention that *when the tax liability* was incurred the meaning of 'net income from the property' was as plain as Congressional declaration and legislative approval of the Treasury's ruling could make it. Under the rule in *Biddle v. The Commissioner,* supra, taxpayers in making their returns are entitled to rely upon the law as it then is. They are not required to have the prescience to discern

a difference in Congressional viewpoint two years in the future."

Penn. Mutual Life Ins. Co. v. Lederer, 252 U. S. 523.

In the case of *Green & Milani v. State Revenue Commissioner,* 4 S. E. (2d) 144, the Court stated at page 145:

"In the instant case, contrary to the facts in both the *Bradley* and *Lazear* cases, all of the profits here involved accrued during the year when the act was adopted, to-wit, 1929, and there appears to be no reason why the general rule which has been stated should not be given application."

This case, as others, supports the Petitioner's contention that the retroactive effect of taxing statutes will only affect transactions which take place during the year in which the statutes are enacted. Therefore, it clearly appears from not only the cases cited by Petitioner but also the cases on which the Board of Tax Appeals relies in support of its decision that although taxing statutes may be retroactive in effect still they will not be supported by the Courts and held constitutional if their retroactive effect reaches too far back into the past and if such effect is arbitrary and capricious and works a great hardship on the taxpayer and thus takes his property without due process of law. Also, the cases hold that the retroactive effect of taxing statutes will not be put into force so that they will affect transactions which have taken place in a year prior to the year in which the act was enacted. Therefore, following these cases it

definitely appears that Section 218(a) cannot affect the transactions which took place in 1932, to-wit, the net loss sustained by the Petitioner, because that is not the year in which the National Industrial Recovery Act was enacted, and still be constitutional. Also, if such statute is considered constitutional it will have an arbitrary and capricious effect and will amount to the deprivation of property of the Petitioner without due process of law within the limits of the 5th Amendment. Therefore, since the Section 218(a) was to take effect as of January, 1933, and as such deprives the Petitioner of setting up as a deduction losses sustained in 1932 (transactions which took place in the year prior to the year when the Act was enacted) such section is unconstitutional and of no force and effect.

D. SECTION 218(a) OF THE NATIONAL INDUSTRIAL RECOVERY ACT IS NOT APPLICABLE TO THE CALENDAR YEAR 1933.

It is the contention of the Petitioner that if Section 218(a) of the National Industrial Recovery Act is considered constitutional and is allowed to, in effect, repeal Section 117 of the Revenue Act of 1932, that said Section 218(a) did not go into effect nor was it the intention of Congress to put the same into effect as to the repealing of Section 117 until the subsequent year, to-wit, 1934. In the report of the Senate Finance Committee, 73rd Congress, First Session, Senate Report No. 114, states in referring to Subsection (a) of Section 217:

> "Subsection (a) of Section 217 removes the privilege granted under existing law to a taxpayer of carrying over a net loss in reduction of his net income for the subsequent year. A similar provision is contained in the House Bill."

In *Seidman's Legislative History* at page 418, the author refers to said report and states as follows:

> "Subsection (a) of Section 217 (which became Section 218 of the Act) removes a privilege granted under existing law (the existing law obviously being the 1932 Act) to a taxpayer of carrying over a net loss in reduction of his net income for the subsequent year."

It would seem that the term "subsequent year" means the year subsequent to the year concerning which the enactment was made. The enactment was specifically for the year 1933 because the repeal is made effective as of January 1, 1933. It would seem clear, therefore, that the first year in which the repeal is made effective is 1933 and the first year which is subsequent would be the year 1934. It is equally obvious that 1933 could not be a subsequent year to the effectiveness of the enactment because the Act was made effective as of January 1, 1933, and clearly the year 1933 could not be subsequent to the year 1933. Therefore, in following the intent clearly expressed by Congress at the time the Act was enacted and following the reasoning as set forth above it clearly appears that the privilege to carry over and deduct net losses sustained in a previous year was not actually done away with until 1934. Therefore, the

statute did not have any effect on the income tax return of the Petitioner for 1933 and he should, therefore, have been allowed to set up a net loss which he sustained in 1932 as a deduction from his gross income in his 1933 return.

It also appears that Congress had in mind the fact that if Section 218(a) of the Act was allowed to go into effect in 1933 so that it would affect the 1933 income tax return of a taxpayer that it would therefore be unconstitutional as it would cover transactions which took place in 1932 and which were prior to the year when the Act was enacted. Therefore, in order to avoid this question of constitutionality Congress intended that the Act would commence to operate on income tax returns for 1934 and would, therefore, not allow net losses sustained in 1933 to be carried forward and used as a deduction in 1934, thus, Section 218(a) would have the retroactive effect of covering net losses sustained prior to June, 1933, but not prior to January 1, 1933, which is the retroactive effect that the cases cited by the Board of Tax Appeals uphold and claim to be constitutional.

The Board of Tax Appeals also states, citing two cases in support thereof, that the allowance of deductions from gross income for purpose of determining taxable income is a matter of "legislative grace". Your Petitioner concurs with the Board of Tax Appeals and agrees that such is "legislative grace". However, as is pointed out in the case of *Helme v. United States,* 23 Fed. Supp. 787:

> "The granting or denying of credits and deductions is a matter of 'legislative grace' and is left

> to the sound discretion of Congress. Such provisions may be held invalid only when shown to be arbitrary and capricious or to result in gross and patent inequalities. *Brushaber v. Union Pacific R. R. Co.,* 240 U. S. 1."

It is the contention of the Petitioner that if the right to make the deduction in question was taken away from him in the manner in which the Commissioner has endeavored to do so that such would work a great hardship on him and would be arbitrary and capricious and would be a mishandling of "legislative grace" by Congress and would be in violation of the law as set forth in the case of *Helme v. United States,* supra.

CONCLUSION.

It is respectfully submitted that Petitioner should be allowed, as a deduction in his 1933 income tax return, the net loss of $63,426.02 sustained in 1932, which is attributable to the operation of his business, from his gross income and that there is no deficiency tax due from the Petitioner for the year 1933 and that the decision of the Board of Tax Appeals is erroneous and should be reversed.

Dated, San Francisco, California,
May 8, 1940.

Respectfully submitted,
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Attorney for Petitioner.